

July 1, 2006

Honorable Mayor and Members of the City Council:

The following is the adopted budget for fiscal year 2007, which serves as an update to the spending plan that Council approved on June 28, 2005. At that time, in accordance with State law, Council adopted a two-year spending plan for fiscal years 2006 and 2007 and approved appropriations for the first year of that plan. Appropriations for the second year of the plan must occur before July 1, 2006; accordingly, Council unanimously adopted the fiscal year 2007 budget on June 20, 2006. This budget update presents Council with a budget for fiscal year 2007 that reflects full-year funding for all mid-year changes adopted by Council and addresses new funding priorities unforeseen when the initial two-year plan was developed.

Throughout this document, the fiscal year 2007 budget that was approved by Council as part of the biennial budget is referred to as the spending plan, while the updated budget is referred to as the fiscal year 2007 adopted budget. The focus of this report is to highlight the changes from the adopted spending plan to the budget adopted by Council approving appropriations.

The fiscal year 2007 all funds budget totals \$308.0 million; a \$33.5 million (or 12.2%) increase over the fiscal year 2007 spending plan. This is primarily due to increases in the Redevelopment Agency (\$10.3 million), Capital Improvement Funds (\$9.7 million), and the General Fund (\$8.3 million). The increase in the Redevelopment Agency budget is primarily due to anticipated payments related to the Gateway Project, which is reflected as a loan repayment from the Merged Project Area (\$4.3) and in the Bayfront/TC I project area as a payment to Gateway (\$4.3). The updated RDA budget also includes the addition of an Executive Director of the Chula Vista Redevelopment Corporation and the CVRC monthly stipends.

The increase in Capital Improvement Funds is primarily due to newly budgeted Development Impact Fee expenditures, including TDIF funds for the Heritage Road Bridge CIP (\$3.5 million) and PFDIF funds reimbursing the City for the acquisition of the Rancho del Rey Library site (\$4.0 million). The General Fund budget increase is primarily due to the new positions approved by Council mid-year and increases in personnel services for higher PERS costs, health insurance premiums, and MOU adjustments. In fiscal year 2007 PERS costs increased by approximately \$1.8 million due to new personnel, higher salaries per the memorandums of understanding, and adjustments to reflect additional costs associated with the employer paid member contribution and PERSable differentials.

General Fund revenues for fiscal year 2007 are once again projected at levels sufficient to fund the operating budget without dipping into reserves, which proved to be particularly challenging this year. Revenue shortfalls experienced by Police, Planning and Building,

and Engineering during fiscal year 2006 are expected to continue into fiscal year 2007. In Planning and Building and Engineering, deposit based developer revenues have been reduced approximately \$1.9 million to reflect declining development activity. Police Department revenues have been reduced \$343,000 to reflect delays in finalizing jail contracts with other law enforcement agencies and \$269,000 to reflect the elimination of state booking fee subventions. Citywide, program revenues have been reduced by more than \$3.0 million.

While the increases in major revenues, such as property tax, and several one-time revenue enhancements were sufficient to mitigate these impacts to the budget, the increase in General Fund revenue was not sufficient to meet the reserve balance of 8%. Therefore, Council approved the transfer of reserves from the technology and equipment replacement funds to bring the fiscal year 2007 General Fund reserve to 8%. This transfer was approved with the adoption of the fiscal year 2007 budget on June 20, 2006.

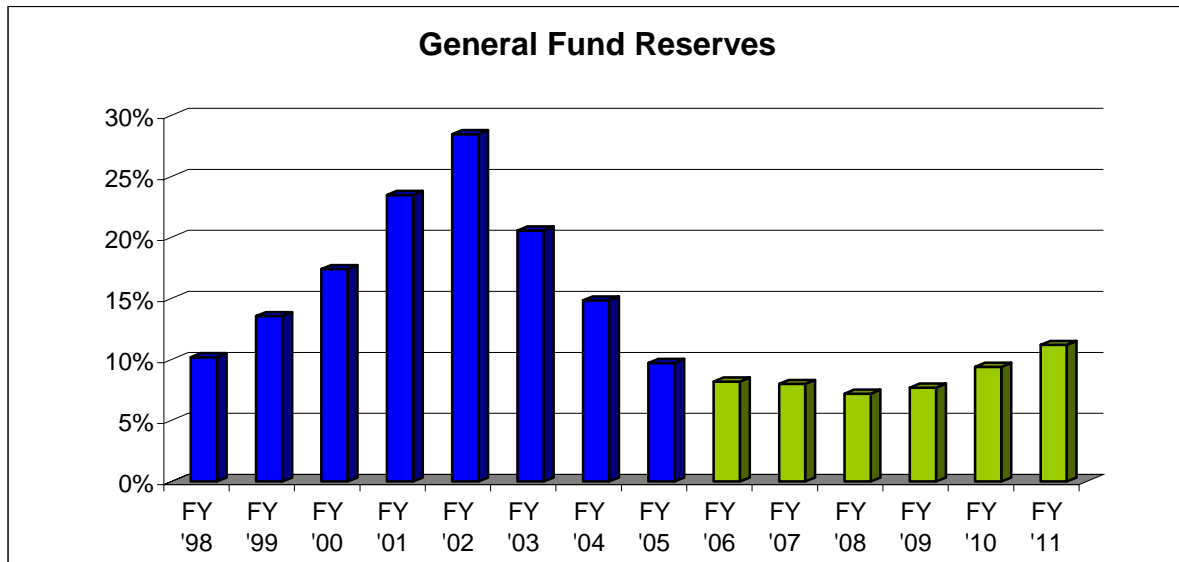
As evidenced by the chart on the following page, the General Fund reserves were at an all time high of \$31.2 million or 28.5% of the operating budget at the end of fiscal year 2002. At the end of fiscal year 2005, the General Fund available reserves were \$15.1 million or 9.7% of the operating budget, just above the 8% policy level adopted by Council. The reduction in reserves, \$16.1 million over this time, occurred due to a combination of significant State revenue takeaways and mid-year appropriations as summarized below:

- State Revenue Take Aways of \$5.3 million - (\$3.5 million for Vehicle License Fee Gap and \$1.8 million for ERAF III)
- Fire Department Staffing, Fire Station and Equipment enhancements - \$3.8 million
- Purchase of Oxford Property for development of Harbor Side Park - \$2.3 million
- Unanticipated Litigation and Workers Compensation Costs - \$2.1 million
- Fire Department Computer Aided Dispatch Center - \$1.8 million
- Municipal Utility Study/Franchise Negotiations - \$1.4 million
- University Study - \$1.0 million

The City's General Fund reserves placed the City in the enviable position to withstand the State's revenue cuts during the past two years and provided the City with the opportunity to reinvest back into the community.

During fiscal year 2006, the following impacted the General Fund reserves:

- Police Department mid-year appropriation requests of \$1.7 million and projected revenue shortfalls of \$1.2 million
- Revenue shortfalls in the Development Services Departments - \$3.3 million



*Reserves for fiscal years reflected as of June 30. Reserves from fiscal years 2006 to 2011 are based on projections.

The projections included for fiscal years 2006 to 2011 are based on the Finance Director's separate General Fund Five-Year Forecast 2007 – 2011 report updated to reflect Council's action to transfer reserves from the technology and equipment replacement funds to the General Fund. The forecast assesses the General Fund's ability to continue current service levels based on anticipated growth and maintain existing infrastructure and existing assets. The forecast also assesses the General Fund's ability to fund new initiatives such as Phase III of the Civic Center Expansion and the opening of the Rancho del Rey Library.

The General Fund reserves are anticipated to decrease to 7.2% in fiscal year 2008 but begin to increase in fiscal year 2009 and exceed the Council policy by fiscal year 2010. These projections assume continued increases in sales and property taxes due to the anticipated opening of the Otay Ranch Town Center and continued development in the east. The projections take into account personnel costs based on the approved staffing included in this budget as well as debt commitments. They do not include the full implementation of the Police Strategic Plan or potential changes suggested by the Fire Facility Master Plan being prepared. Funding for such major initiatives may likely require tradeoffs during the budget process in future years.

These projections are discussed in further detail in a separate report – the General Fund Five Year Forecast 2007 – 2011 report.